By Invitation

Two Crises, Two Remedies & Two Consequences: Impacts on Korean Labour Market

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The recent global financial crisis is similar in many respects to the one Korea experienced in 1997. During both the crises, the exchange rate of Korean won vis-à-vis the US dollar soared, the stock market prices plummeted, and the Korean economy experienced a serious drop in output and then quickly recovered. Despite such similarities, the two crises are different on their impacts on the labour market. While the former was accompanied by massive layoffs and severe unemployment, there was no such impact in the latter. This paper argues that the conditionality of the IMF, especially the macroeconomic and structural policies, as a precondition for its loans is the primary factor that engendered these contrasting and divergent labour market performances. The conditionality was neither necessary nor appropriate. The Korean economy performs better without the conditionality.

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Introduction

In 2010, the Korean economy has recorded a growth rate of 5%, the second highest among the OECD countries, recovering completely from the fallout of the 2008 global financial crisis that swept through almost all countries around the globe. Indeed, the Korean economy has lifted itself out of the recession faster than other industrialized countries. This quick recovery is not unprecedented. When the Korean economy was hit by the currency crisis 13 years ago, no one had expected such a rapid recovery. After experiencing a negative 7% growth, Korean economy bounced back quickly, regaining its normal growth rate.

The two financial crises that Korea experienced have many similarities in their causes, sizes of shock and recovery patterns. There is, however, one big difference. Their impacts on the Korean labour market, especially on employment, show a sharp contrast. In 1998, when the Korean economy was in the midst of the most serious recession caused by the currency crisis, the unemployment rate soared up higher than 8% from a mere 3% in the preceding years. The consequent economic hardship is still very vivid in the minds of many Koreans, with numerous tragic stories for the families who lost their jobs. In 2009, there was no such a hardship. Despite the recession, the Korean economy managed to retain more or less its normal employment level.

The conditionality was neither necessary nor appropriate.

This paper tries to examine why and how the two crises ended up with such contrasting experiences, although the shocks look similar. The paper argues that the conditionality of the IMF, especially, the macroeconomic and structural policies that the IMF enforced on the Korean government in 1998 to accept as a precondition for its loans is the primary factor that engendered contrasting and divergent labour market performances. The conditionality was neither necessary nor appropriate. The macroeconomic policies were wrong. The structural policies were inappropriate, neglecting the social aspect of the reform. The situation of the Korean economy after the 2008 global financial crisis shows that this is really the case.

There are some recent studies investigating the factors that affected the divergence in the labour market performance. For example, Cho (2010) focuses on the difference of macroeconomic policies. Eskesen (2010) considers different economic and social institutions as the most important factors that generate divergent employment performances. These studies, however, do not clarify enough the role of the conditionality in the diverging labour market performances. This article compares the crises of 1997 and 2008 in light of their general patterns and shows the differences in labour market performances. The paper then raises the question whether the conditionality is a *sine qua non* for successful recovery. The paper then goes on to examine the appropriateness of the IMF-led macroeconomic and structural policies.

The patterns of 1997 & 2008 Crises

Figures 1-4 summarize the situation in Korea during the periods of the Asian and global financial crises. In 1997, Korea was hit by the financial crisis that happened first in Thailand, spread to other Asian countries, and eventually embroiled Russia and Latin American countries. The exchange rate of the Korean won vis-à-vis the US dollar soared to 1700 KRW per dollar from below 1000 KRW per dollar. The stock prices plummeted as well. The foreign reserves were completely depleted as foreign investors withdrew their capital and refused to roll over their existing loans to Korea. As a result, the growth rate of GDP fell sharply to -7.3% in the second quarter after experiencing -3.5% in the first quarter of 1997, the first negative growth Korea had ever recorded since the second oil shock during 1979-81. The recovery, however, was very quick. From the first quarter of 1999, the Korean economy was already in the recovery process, drawing up its growth rate to 6.4 %.

In 2008, Korea was hit again by the financial crisis. This time, the epicentre of the crisis was the US ("a made-in-the US financial crisis") but Korea and many other emerging economies were not immune to this crisis. The exchange rate of the Korean won vis-à-vis the US dollar soared to 1400 KRW per dollar, the highest rate since the 1997 currency crisis. On the same day, the stock price dropped to below 1000. Compared to the peak point in December 2007, this was a drop of more than 50 percent. The skyrocketing Korean Won was, first of all, the result of the capital outflows triggered by mutual and pension funds in the industrialized countries that were trying to scale back their emerging market exposure. More importantly, it was the result of Korean banks' incapacity to borrow the US dollar in the one-sided and illiquid US money market generated by the global financial crisis. As its foreign exchange market fell into a big turmoil, Korean government intervened without avail. Korea had more than $250 billion worth of foreign exchange reserves, but this large stock of foreign exchange reserves, which was nine times as large as the foreign exchange reserves in 1997, did not help to stabilize the exchange market. The currency swap

Fig. 1: Won-Dollar Exchange Rate (Monthly)

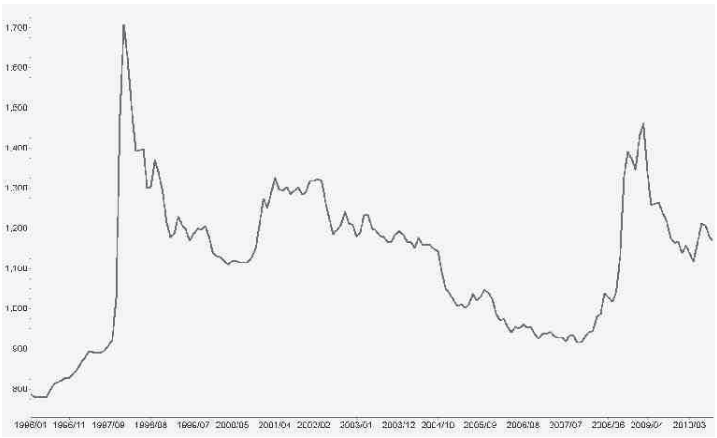
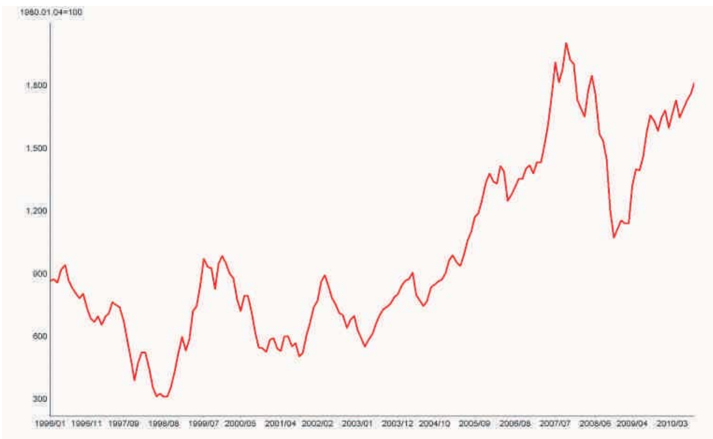


Fig. 2: Stock Price Trend (KOSPI)



worth 30 billion dollars with the US helped. Coupled with it, the confidence in the continuing trade surplus aided to recover the market trust and stabilize foreign exchange markets.

The recovery of the Korean economy was as quick as it was during the 1997 Asian currency crisis.

Fig. 3: Foreign Reserve Holdings

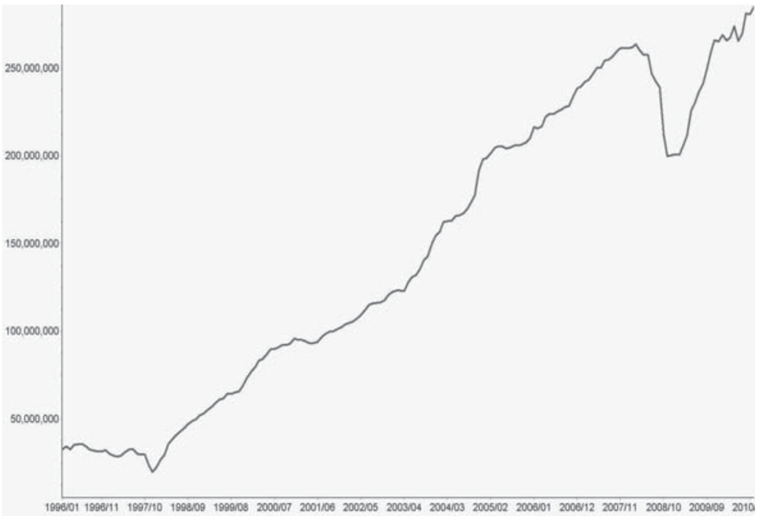
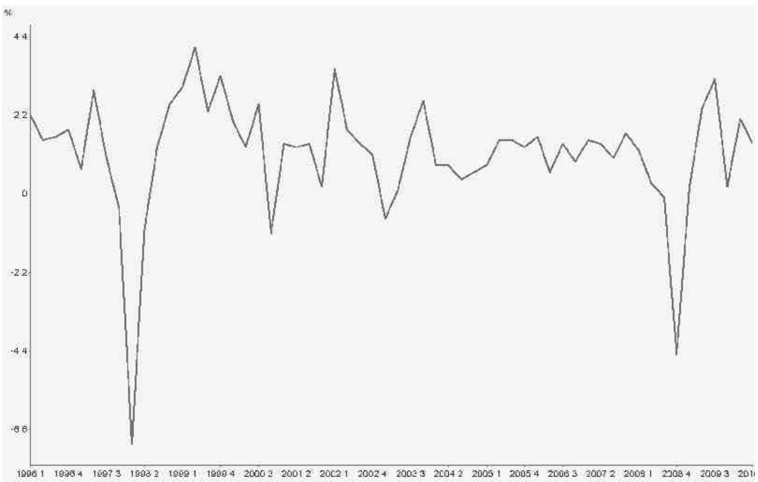


Fig. 4: Growth Rate of Real GDP



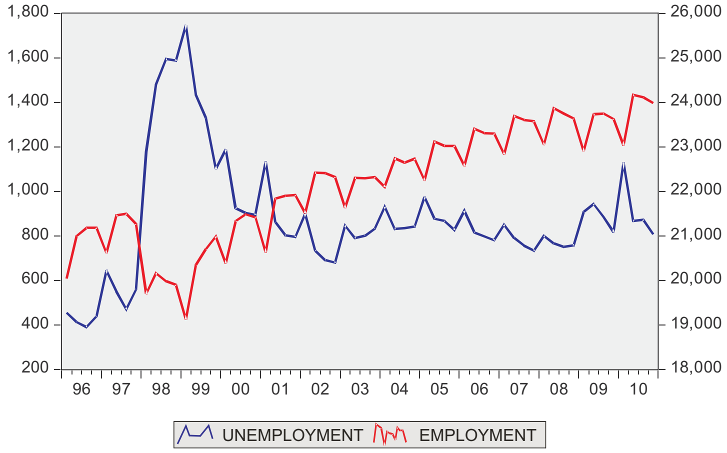
Source: Bank of Korea

The 2008 global crisis had a serious impact on the national output. The growth rate of GDP turned into -3.3% in the fourth quarter of 2008 from 3.3% in the third quarter of 2008 and then dropped further to -4.3% in the first quarter of 2009. However, it bounced back quickly to 6% in the fourth quarter of 2009. The recovery of the Korean economy was as quick as it was during the 1997 Asian currency crisis.

It appears that the two crises of 1997 and 2008 are very similar in their causes, impacts on output and recovery patterns. These crises were both triggered by the sudden capital outflows accompanied by the previous capital inflows. Faced with the threat of the capital withdrawal, the Korean economy had to continuously stockpile its international foreign reserves. A fear of dollar shortage was the main reason behind foreign reserve hoarding by many Asian and emerging countries, although the cost of such a foreign reserve hoarding is significant. National output plummeted and bounced back quickly during these crises periods. However, their social consequences, especially the labour market reactions, were quite different.

Fig. 5: Unemployment & Employment Rates

Fig. 6: Number of Unemployed & Employed People (Thousand Persons)



Source: National Statistical Office, Korea

Employment Performances: Now and Then

Despite many similarities that exist between the two crises of 1997 and 2008, their labour market performances are in sharp contrast. This is clear from fig. 5, which shows the trends in unemployment and employment rates, defined as the proportion of the employed people to the total working age population 15 and above, and from fig. 6 that shows the number of unemployed and employed people.

During the 1997 Asian financial crisis, the unemployment rate in Korea soared from mere 2.3 % in the fourth quarter of 1997 to 8.4% in the first quarter of 1999. At the same time, the number of unemployed people increased from 0.4 million to 1.7 million. More than 1.2 million people, which accounted for about 6% of the total working age population, lost their jobs. There were massive and large scale layoffs due to the restructuring. According to the Korea Labour Institute (2000), it was reported that 66% of all the listed Korean companies laid off their workforce during the currency crisis period. This spectacular rise in the unemployment, which was never experienced before, caused numerous Koreans not only serious economic hardships but also social tragedies such as family dissolution and suicide. This trend was reversed only when the Korean economy regained its normal growth path after 2001. Unlike the 1997 currency crisis, however, the unemployment rate during the period of recent 2008 global crisis remained rather stable. The unemployment rate went up slightly to 4.7% only in the first quarter of 2010 and remained at around 3% throughout the whole period of the global financial crisis. As the number of unemployed people increased only slightly, there were few news on the social and economic consequences of unemployment.

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The two crises are also different in their impacts on specific labour market sectors. Tables 1 and 2 show the changes in the number of employed people according to their employment status and gender. During the 1997 currency crisis, the impact of the crisis focused primarily on the wage workers, while the impact on the non-wage and self-employed workers was secondary. For instance, the number of wage workers who lost jobs was more than five or six times that of non-wage workers. Further more, among the wage worker group, the impact of the crisis was the

Table 1 Changes in the Number of Employed People by Status of Workers

(Unit: 000 persons)

	1998				2009			
	I	II	III	IV	I	II	III	IV
Total employed	-925	-1,302	-1,514	-1,365	-147	-134	0	-6
Non-wage worker	-147	-125	-206	-196	-220	-309	-356	-391
Wage worker	-778	-1177	-1308	-1169	74	175	356	385
-Regular	-589	-817	-797	-788	318	313	386	515
-Temporary	44	-107	-314	-399	-136	-5	125	104
-Daily	-234	-254	-197	18	-108	-133	-155	-235

Note: The changes are calculated on a quarter to quarter basis.
Source: National Statistical Office

Table 2 Changes in the Number of Employed People by the Gender of Workers

(Unit: 000 persons)

	1998				2009			
	I	II	III	IV	I	II	III	IV
Total employed	-925	-1,302	-1,514	-1,365	-147	-134	0	-6
Male	-375	-647	-799	-722	-22	25	34	89
Female	-551	-656	-715	-642	-124	-159	-35	-94

Note: The changes are calculated on a quarter to quarter basis.
Source: National Statistical Office

largest for regular jobs. In contrast, the 2008 global financial crisis hit the non-wage workers directly, while influencing the wage workers less. Among the wage worker group, the daily workers were the largest victims of the crisis, while the regular workers saw the numbers of their jobs increasing rather than decreasing. Additionally, the 1997 Asian currency crisis impacted the male and female workers somewhat evenly, while the 2008 global financial crisis disfavoured the female workers far more than the male workers.

These divergences can be traced back to the fact that Korea received the emergency support under the "conditionality" imposed by the IMF

As explained by Moon (2009), the 1997 financial crisis profoundly transformed the Korean economy, especially the Korean labour market. In contrast, the impact of the 2008 global financial crisis on the Korean labour market is hardly visible. What is then the cause of these divergent labour market reactions? These divergences can be traced back to the fact that Korea received the emergency support under the "conditionality" imposed by the IMF and the US (behind the IMF) during the 1997 Asian currency crisis. Indeed, in 1997, the Korean economic model itself was blamed for its crony capitalism, excessive leverage, lack of transparency etc, and had to accept the prescription known as the Washington Consensus that promoted market liberalization and fiscal responsibility. Thus, Korea was forced to adopt a massive restructuring program for the banking and corporate sectors that would have been hardly possible unless enforced to do so by the IMF.

During the 2008 global financial crisis, however, Korea relied on the swap arrangement with the US for an emergency borrowing, which allowed it to adopt an autonomous expansionary macroeconomic policy without any prior intervention of the IMF and avoid a structural policy for banking and corporate sectors.

Conditionality as a Necessary Condition

In 1997, the IMF was the sole source of the dollar funding for Korea. The crisis was entirely attributed to the inherent failure of the Korean economic model, although the crisis could have happened to any emerging economy due to the "Original Sin" (Eichengreen et al 2003). There was little need for industrialized countries such as the US to help Korea in an emergency situation. For a country like the US, the dollar is our currency but the crisis is your problem. In 2008, the epicentre of the crisis was the US. However, Korea was victimized because the de-leverage process of the US financial market triggered the capital outflows. Korea needed international support but it was impossible for Korea to resort to the IMF. First, the provision of liquidity coordinated by IMF came after the collapse of the system, rather than being used to pre-empt large currency swings. More importantly, harsh conditionality was the most critical factor preventing the Korean government from borrowing from the IMF. The "conditionality" was 'too harsh in the Korean crisis" (Siebert 2008) and the IMF and the US advanced "their interests not at the point of a gun but at the tip of a check-signer's pen" (Rothkopt 2008) Indeed, it will be very difficult to imagine that countries like Korea that experienced the 1997 financial crisis rely again on the IMF, because the fact that they have to borrow money from the IMF would suggest that their economic policies have failed (stigma effect).

The swap arrangement was rarely available for emerging economies.

The bilateral swap arrangement with the US was the more desirable and appropriate alternative for Korea because the loan was automatically granted without conditionality. However, the swap arrangement was rarely available for emerging economies. The swap arrangement of the US was made so far only for the central banks of industrialized countries. The decision by the US Federal Reserve System to extend these swap agreements to the central banks of four emerging economies such as South Korea, Singapore, Mexico and Brazil was an important step in the direction of reinforcing the global financial safety net. Speaking on the difference between the 1997 Asian crisis and 2008 global crisis, the IMF managing director, Strauss-Kahn said: "What originated in Thailand and spread to Korea, Indonesia, and other countries was mainly a balance of payments problem. That was our core business. This crisis, even if it is a huge crisis, is different. This is a different kind of crisis, so the solution to be applied is not the same. The main actors today are the central banks and treasuries; the main actors in the Asian crisis were institutions like the IMF." (IMF 2008)

As pointed out by Moon (2010), central bank swaps could mobilize much larger sums of money than the IMF did to cope with the 2008 global financial crisis. For instance, while the IMF provided a mere sum of 33 billion SDR to dozens of developing countries, the US Federal Reserve Board concluded a total of 412 billion US dollar swaps with 14 developed and developing countries. Also central bank cooperation proved to be more effective to stabilize the financial system. For instance, figs. 7 and 8 demonstrate that the central bank swap was much more effective in stabilizing foreign exchange markets in Korea, compared to the IMF lending.

Fig. 7: Won-dollar Trend around the IMF Bailout Loan (27 Billion $) in November 21, 1997

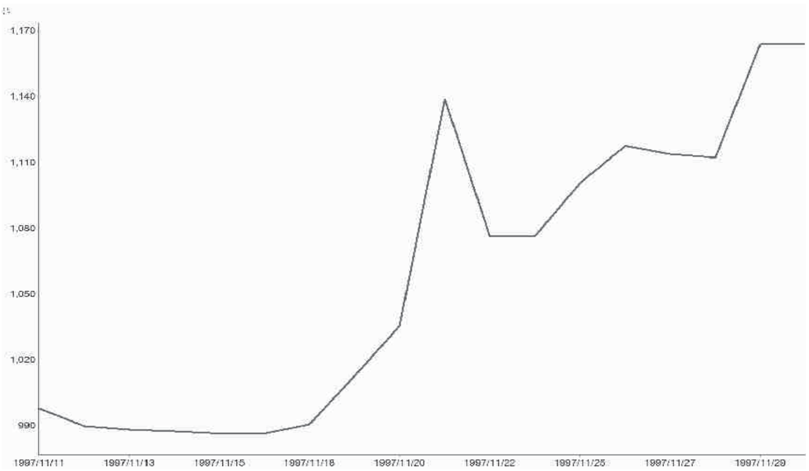
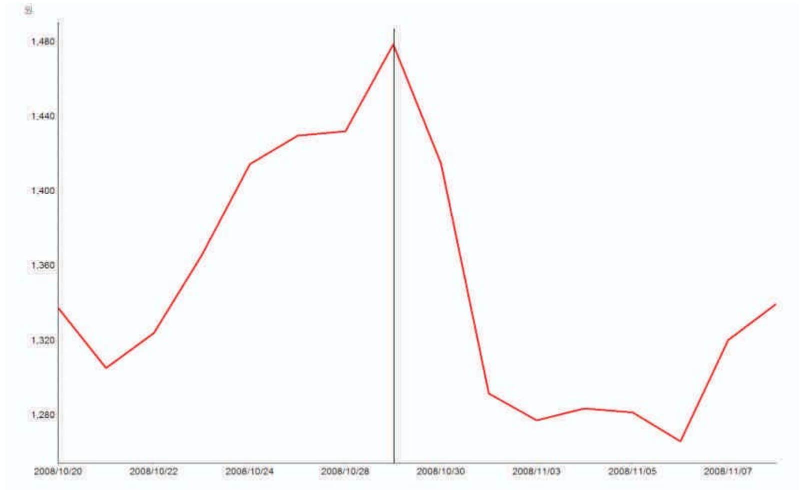


Fig 8: Won-dollar Trend around the Korea-US Currency Swap (30 Bilion $) in October 29, 2008



Source: Bank of Korea

Policy Appropriateness

Macroeconomic Policy

During the period of the 2008 global financial crisis, the Korean government quickly proceeded to lowering interest rates and pumping the necessary liquidity into the Korean economy. The policy interest rate was lowered to 2.00% below half the pre-crisis rate 5.25% in response to the recent crisis. There is no doubt that the monetary easing in 2008 was crucial in guarding the domestic economy from the external storm. (Figs. 9 and 10)

In contrast, the monetary policy was tightened in 1997, raising

Fig. 9: Call interest rate trend during the 1997 currency crisis (monthly)

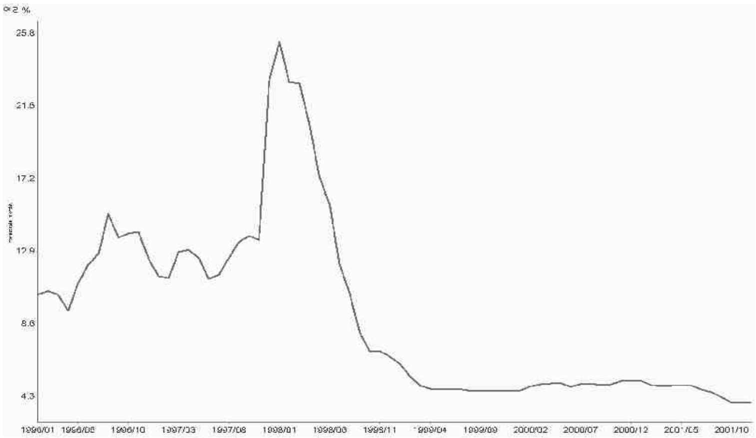
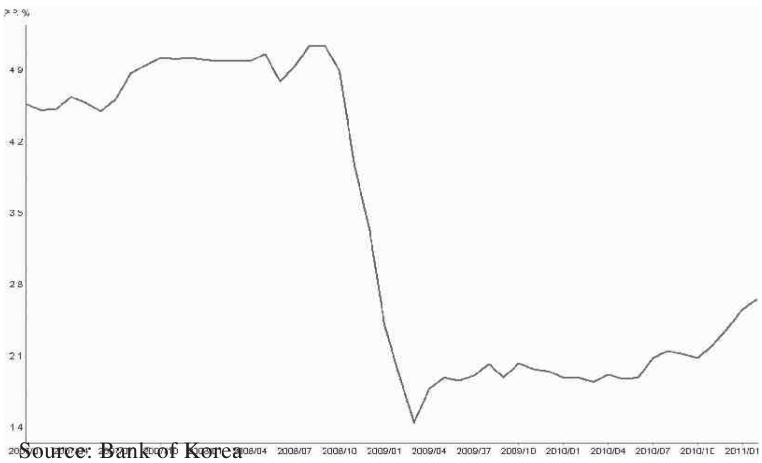


Fig. 10: Call interest rate trend during the 2008 global financial crisis (monthly)



Source: Bank of Korea

the policy interest rate to almost 30% a year above twice the pre-crisis rate which was approximately 12%. In retrospect, this tightened monetary policy had only aggravated the currency crisis, propagating it into a generalized banking crisis. The goal of the high interest policy enforced by the IMF was to prevent the hoarding of the US dollar and the capital outflow from Korea. However, this policy turned out to be not effective in holding foreign capital outflow or attracting foreign capital while it ended up hardening the business environment of domestic firms who were already in difficulties. In fact, the ratio of dishonoured bills increased from 0.5-0.6 percent in mid-1998 to more than 1.5 percent in mid-1999 (Cho 2010). A number of small and medium sized companies that went bankrupt could have been saved, if not for the high interest rate policies implemented during the crisis period. The vicious circle soon spread to big firms and financial firms. Such bankruptcies aggravated unemployment problems and the high interest rate policy had to be reconsidered. This bitter experience was critical in mistrusting the IMF.

More interesting than the policy effects, however, was the international economic environment that led to easy monetary policy. The US and other advanced countries aggressively lowered their interest rates to cope with their own financial crises in 2008, contrary to what Korea and other Asian countries were obliged to do in 1997. This proves again that the tight monetary policy Korea had to adopt with the interest hike during the 1997 Asian crisis was neither economically appropriate nor politically right. Indeed, the low interest rate policy in the US helped Korea to lower its own interest rate in 2008, despite the exchange rate depreciation.

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Among the macroeconomic policy reactions to the crisis, fiscal policy reactions were similar. Expansionary fiscal stances were assumed in both the periods, with a budget deficit of approximately 3 percent of the GDP. However, the processes of similar results were different. In 2008, the Korean government adopted a pre-emptive fiscal policy, announcing to increase the public expenditures as soon as the recession would appear (Cho 2010). In contrast, the IMF-led macroeconomic policies in 1997 did not allow the pre-emptive expansionary fiscal policy until the recession developed into the depression. The increase in government expenditures since 1997 was primarily to build up the necessary social safety net, which was little developed until then. As a consequence, the public outlays for social safety net increased sharply. The inevitable fallout of increasing expenditures for social programs led to a large jump in the fiscal deficit and an increase in public debt. For instance, the level of public debt jumped to 30% of the GDP from below 20% of the GDP in 1996 (Moon 2009).

The IMF-led macroeconomic policies in 1997 did not allow the pre-emptive expansionary fiscal policy until the recession developed into the depression.

Structural Policy

Among the policies led by the IMF, the most controversial ones were the structural policies. The structural policy is not in the area of the proper competences of the IMF. As a precondition to the IMF loans, however, the Korean government had to commit a very comprehensive reform to the IMF. When the crisis hit Korea in 1997, it was clear that the Korean economy could no longer maintain its traditional growth model. Based on the cooperative relation between the firm, bank and government, the traditional model allowed Korea to generate high growth rate for almost 40 years up to the 1997 currency crisis. This system fomented the permanent employment and the seniority wage system, which was especially the case for the public sector and large firms. Thus, there were few layoffs in Korea and job security was automatically ensured (Moon 2009). The restructuring however marked the end of such a growth regime.

It is true that the restructuring helped the Korean companies to solidify their economic and financial conditions and thereby to avoid massive layoffs and large unemployment during the 2008 global financial crisis. The sound fundamentals however were not made without costs: The Korean economy had to suffer from mass unemployment.

First, there was a comprehensive restructuring in the financial sector. The emergency fund from the IMF was accorded only under the condition of banking sector reform packages. Because the top priority in the financial sector restructuring was given to the earliest possible resolution of unsound financial institutions, there immediately happened a massive close-down of financial firms and a large scale layoff of their staff.

Second, the Korean corporate sector also had to lower its debts and bank borrowings. As the profitability oriented management replaced the growth-oriented management as a new norm, fixed investments drastically declined, inducing a growth rate slowdown of the Korean economy. Furthermore, layoffs were allowed as a necessary and inevitable step. As pointed out, layoff was considered illegal. Thus the Korean government tried to revise the labour law in 1997, allowing layoffs, but faced with the strong opposition of labour unions, it had to postpone the actual implementation until two years later. In 1998, the labour law was revised again, at the instance of the IMF, to abolish these two year grace period. Thereafter, unemployment emerged as a big problem as Korean firms were following the global trend of downsizing and restructuring through massive labour shedding. Table 3 shows the labour adjustment in the financial and corporate sectors that took place since the turmoil of the 1997 and 2008 financial crises.

Table 3 Employment Trend in Banking & Industrial Sectors during Asian & Global Financial Crises.

(Unit: Number of Persons & Trillion Korean Won)

		Asian financial crisis period					Global financial crisis period		
		1996	1997	1998	1999	2000	2007	2008	2009
Banking sector	Employees	103913	113994	75677	74744	70559	72987	74830	75639
	Total asset	415	542	560	550	580	1096	1306	1249
Industrial sector	Employees	199103	197354	180803	168093	168636	198267	196515	192080
(Sub-total)	Sales value	45.6	50.8	51.3	65.3	80.9	176.8	204.4	224.2
Samsung	Employees	59086	57817	42154	39350	43996	84721	84462	85085
Electronics	Sales value	15.8	18.4	20	26.1	34.2	98.5	121.2	138.9
Hyundai	Employees	47098	46196	51900	50984	49023	55629	56020	55984
Automobile	Sales value	11.4	11.6	8.6	14.2	18.2	30.6	32.1	31.8
Korea Telecom	Employees	61024	61024	56600	47532	46095	36913	35063	30841
	Sales value	6.9	7.7	8.7	9.5	10.3	18.6	19.6	19.6
Korea Electricity	Employees	31895	32317	30149	30227	29522	21004	20970	20170
	Sales value	11.5	13.1	14	15.5	18.2	29.1	31.5	33.9

Source: Financial Supervisory Board, Korea

The IMF reform package did not pay due attention to the social effect of reform, in particular, the massive lay-offs in a country where the social safety net or the capacity that could effectively absorb that flux of unemployment was absent.

The large and massive labour shedding by Korean banks and companies that was accomplished over the time span of several months without taking into full account its social consequences had rarely been observed in the history of world economies. The problem of such remedy is not that its purpose was wrong but that it did not consider the circumstances and the consequences of imposing such an extreme restructuring. In particular, the IMF reform package did not pay due attention to the social effect of reform, in particular, the massive layoffs in a country where the social safety net or the capacity that could effectively absorb that flux of unemployment was absent or at most insufficiently developed. Although the Korean government introduced a new work-based social welfare system called a "Productive Welfare" system and proceeded to implementing active job creation and re-equipment of unemployed, numerous households had to suffer seriously in the meantime. The IMF itself acknowledges it: "The IMF learned important lessons from the Asian crisis. In particular, the Fund recognizes that while tough measures are needed to address deep economic problems, the conditions accompanying its programs need to be more focused on the problems at hand, and it needs to be more conscious of the social impact of those programs" (IMF 2010).

The painful large scale restructuring and massive layoff that Korea had to accept during the 1997 currency crisis is still vivid in the minds of millions of Koreans. One important lesson that Korea learned from the 1997 currency crisis was that such massive layoffs should never be repeated. Certainly it hurt companies as well as labour because, as a result of the layoff, many Korean companies experienced a severe shortage of skilled workers later on. When the global financial crisis hit Korea, there was a feeling of emergency calling for the prompt action of Korean government to act quickly to prevent the crisis and avoid the mass unemployment. It was expected that the Korean economy would face an even worse situation than that of the 1997 crisis. Specifically, the Korean government launched a large scale public work program that would help to employ nearly 1 million people, created various temporary works, and introduced diverse job-sharing programs including wage cuts for additional employment and subsidy for job-sharing companies. Korean companies and labour unions responded very favourably to these government initiatives, trying to retain as many jobs as possible and even create new jobs.

Conclusion

The recent global financial crisis is similar in many respects to the financial crisis that Korea experienced in 1997. Despite such similarities, however, the two crises are different in the sense that the 1997 crisis was accompanied by massive layoffs and serious unemployment problems, while the 2008 global financial crisis had little impact on unemployment in Korea. The fact that few Koreans suffered from the global crisis was a real relief to most Koreans who still had vivid memories of the 1997 financial crisis. This article argues that the conditionality is neither necessary nor appropriate. The macroeconomic and structural policies enforced by the IMF amplified the social adjustment and aggravated the unemployment problem. The experience of the 2008 global financial crisis was a counter example showing that Korean economy could perform better without the conditionality. Precisely, three factors contributed to mitigating the effects of shocks.

The 1997 crisis was accompanied by massive layoffs and serious unemployment problems, while the 2008 global financial crisis had little impact on unemployment in Korea.

First, Korea relied on the bilateral swap agreement with the US, which did not require any prior conditionality for the emergency dollar borrowing. It turned out more stabilizing compared to the IMF loans. Second, the macroeconomic policies were used pre-emptively to prevent the recession and the consequent unemployment. In fact, both monetary and fiscal policies were expansionary. In contrast, the IMF-led macroeconomic policies in 1997 were not appropriate to cope with the recession. Third and the most important, there was no structural restructuring that pursued blindly the economic logic at the cost of social stability, whereas the IMF imposed a structural reform in 1997 that necessitated the painful adjustment of numerous individuals. It is true that the restructuring package of the IMF helped Korean companies to solidify their economic and financial fundamentals. However, Korea had to sacrifice millions of jobs, which would not justify the restructuring easily.

Indeed, this experience led Ko

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